ASIA PACIFIC INITIATIVE

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VANCOUVER

AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

SUMMARY DOCUMENT

prepared by:

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ASIA PACIFIC INITIATIVE

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Dr. Peter Lusztig
Chairman
Asia Pacific Initiative
Advisory Committee

Dear Dr. Lusztig:

The Transportation Task Force is pleased to present to members of the Advisory Committee a comprehensive report on the development of Vancouver as an International Centre for Maritime Commerce.

The Task Force began discussing this initiative in February, 1988. It concluded that one of the key steps to encourage the expansion of the marine services industry is the establishment and promotion of Vancouver as an attractive location for the commercial, operational and administrative control of internationally traded ships.

Terms of reference were established for a study which would:

- define the desirable attributes of a headquarters location for international shipping operations;
- assess the position of Canada, and specifically, of Vancouver, with respect to those attributes;
- identify the most likely candidates for relocation;
- recommend a strategic plan to attract those candidates; and
- project the costs and potential benefits to the economy from implementing the strategic plan.

The Task Force has worked closely with the consultant, Jonathan Seymour and Associates, in the preparation of this report and unanimously endorses its conclusions and recommendations.

The report concludes that there is a window of opportunity to attract international shipowners and managers to locate in Canada; and that the benefits to the Canadian economy - including some 1,600 jobs over three years - are substantial.

The study incorporated an extensive interview process with shipowners and senior shipping executives around the world. The results revealed an impressive amount of interest in Vancouver as a Pacific headquarters

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location, as long as an internationally competitive taxation environment could be established. Vancouver was perceived as an attractive place from which to conduct international shipping business and the logical location for an emergent maritime centre on this side of the Pacific.

Vancouver already has the essential attributes to become a centre for management of international maritime operations. To make this happen will require modification of Canadian tax policy to permit the "mind and management" of international shipping ventures to be located anywhere in Canada on a tax exempt basis. This is the central recommendation in the report and has the virtue of being non-regional in application. It is the wish of the Task Force that the Advisory Committee endorse this recommendation and forward it to Ministers as a key initiative in allowing British Columbia to reach its potential as a Pacific Centre for Canada.

Respectfully submitted,

Transportation Task Force
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VANCOUVER - AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

SUMMARY DOCUMENT

1. THE OBJECTIVE

Over the last twenty-five years Vancouver has grown into a substantial regional centre of maritime commerce. The city has the potential to become a major international maritime centre, but this potential remains unfulfilled - because Canadian ownership, management and control of ships engaged in international trade has not developed.

The 90 million tonnes of cargo shipped through Western Canadian ports generates an enormous demand for ocean transportation services - but few of these services are supplied or controlled by Canadian interests.

The objective of this study is to

- **create an internationally competitive business environment suitable for the ownership, management and control of ships engaged in international trade; one which will**

- **permit Vancouver to achieve its natural potential as a major international centre for maritime commerce.**

Canadian involvement in the supply of international shipping services is prevented by a limited number of constraints within the Canadian business environment. The primary constraint identified is the imposition of Canadian taxation at domestic rates on a sector which must compete in the international market place - where every other supplier operates in either a tax-free environment, or receives tax subsidies.

A fundamental restructuring is currently taking place in the national affiliations of international shipowners and ship managers. This change presents Vancouver with a unique window of opportunity.

The adjustment in the Canadian tax rules necessary to seize the opportunity will actually result in increased tax revenues, while generating substantial economic benefit through new jobs and income, and by the enhancement of Canadian trade. Elimination of the tax constraint will ensure that Vancouver has the right business environment to stimulate private sector international shipping activity.

2. THE BENEFITS

The initiative will generate substantial economic benefits in Canada by expanding employment and generating income through:

* growth in shipowning, ship management and the marine services sector
* international business centre development
* enhanced opportunities for trade

Only the shipping management and marine services benefits are quantified in the report. The trade and business centre development aspects will also create economic benefit and generate multiplier effects through the economy.

2.1 THE MARITIME SECTOR

The beneficiaries of the increased employment opportunity in the maritime sector will be in the skilled white-collar, managerial and professional groups.

* **new jobs in shipowning and ship management (800 jobs - short term)**
* **expanded opportunities and additional jobs in the maritime services sector (200 jobs), and**
* **more indirect income and employment (600 jobs).**

2.2 INTERNATIONAL BUSINESS CENTRE DEVELOPMENT

International shipping is a major element in international commerce. Established business centres such as London, New York, and Tokyo have large commercial maritime sectors which service trade. Newer and aspiring international business centres such as Hong Kong, Singapore, and Bermuda view the international maritime sector as fundamental to their development.

* **Expansion of Vancouver's international maritime activity will complement and support the growing international trade, banking, finance, and communications sectors. It will assist in achieving Vancouver's aspirations as a comprehensive international business centre and Canada's Asia/Pacific gateway.**

2.3 TRADE

Easier access to in-depth shipping expertise will allow Canadian exporters and importers greater strategic control of commodity logistics, improving market positioning and minimizing the landed cost of their products.

* **Canadian industry will become more competitive, promoting growth in trade.**

3. ECONOMIC BENEFITS - QUANTIFIED

3.1 SHORT/MEDIUM TERM BENEFITS

A reasonable, short term estimate (year 3) of the economic impact of the initiative is **1,600 Vancouver-based full time jobs**, generating **a payroll income of $60 million**, on **local revenues of $180 million** (expenditure on domestic goods and services) in the year.

The numbers are projected on the basis of between six and twelve shipowners/ managers locating to Vancouver in the short term. The group will be a mixed one, containing various sizes and types of shipowner and having a controlled fleet of some 200 ships in aggregate.

The short term impact on employment is forecast at:

* **direct employment**	**800 jobs**
* **indirect and imputed employment**	
* **marine services**	**200 jobs**
* **others**	**600 jobs**
* **total employment**	**1,600 jobs**

Depending on mix, the **200-ship fleet** would probably represent a **capital stock of US$ 2 billion**. On this basis, Aggregate earnings from freight and hire would approach an **annual cashflow of US$ 1 billion**. The short term economic benefit quantified above assumes, however, that ship financing remains offshore, and that gross earnings are not remitted to Canada; if they were - then the economic impact would increase.

3.2 MEDIUM/LONG TERM BENEFIT

Experience at other centres suggests that there is a "critical mass" in the development process. Once this threshold point is reached, additional shipowners, charterers and maritime service functions will establish major branches or relocate - simply because they cannot afford to be excluded as the market opportunities associated with the centre expand. Hong Kong and Greenwich, Connecticut, are good current examples. In both cases, marine companies continue to move in after some of the original reasons for the creation of the centre have disappeared.

Once the critical point is reached, the economic impact increases dramatically. Employment in the marine services sector is the main beneficiary.

* In both London and Hong Kong it is estimated that there is one person employed in the maritime services sector for each person employed by a shipowner/manager, accordingly:

  the medium term (5/10 years) prospects for Vancouver are exceptional.

For example, Hong Kong shipowners own and control some 1,000 ships. It has been estimated that direct local employment is between 8,000 and 10,000 people, whilst a total of some 20,000 people are employed in the colony in the combined marine and marine services sector.

In addition to general business services, e.g. legal, accounting, banking, and communications, the shipping community does business with, or through, a wide range of specialist marine services, including:

* chartering and S&P (sale and purchase) broking
* ship financing and investment services
* marine insurance broking
* claims adjustment
* marine surveyors
* admiralty lawyers
* arbitration centres
* naval architects and designers
* engineering consultants
* weather routing services
* specialist publications
* classification societies
* registration offices
* representatives/suppliers of spare parts, stores and ship repair

4. THE MAIN CONSTRAINT

The study has established the essential ingredients of a successful international maritime centre. The Vancouver business environment compares very favourably in most respects, with one significant exception:

* **The overwhelming constraint which prevents Vancouver from becoming a major international shipping centre is the hostile and internationally uncompetitive taxation environment.**

In most maritime countries, companies engaged in international shipping receive preferential tax treatment. Extensive capital allowances and grants on ships registered under the national flag have been widely used to reduce, and often eliminate, the tax bite, and to encourage investment in shipping. In addition -

* **Many countries effectively treat the earnings derived from foreign-flag ships owned by offshore subsidiaries as tax exempt. The exemption continues to apply even when the shipping activities of an offshore subsidiary are controlled onshore by a managing agent owned by the parent company.**

In comparison, the Canadian taxation position is much more onerous. Revenue Canada applies the so-called "mind and management" test to international shipping activities which have a Canadian presence. Consequently -

* **If the "mind and management" (the active commercial control) of the international shipping activity is judged to reside in Canada, the worldwide income of the organisation is subject to Canadian taxation - irrespective of source.**

The results of this unfavourable and internationally uncompetitive tax treatment are predictable:

* Canadian organisations intent on owning and controlling foreign-flag ships in international trade have moved their management offshore to environments which are tax benevolent and competitive on an international basis.

Conversely, Canadian organisations more intent on remaining Canadian have either limited their shipping activities or abandoned them.

* Foreign shipping organisations, which would otherwise have chosen to locate all or part of their management to Canada, have not done so.

Alternatively, if a Canadian presence is essential, that presence is restricted to the bare minimum necessary to service the Canadian aspects of the organisation's international shipping operations.

5. THE RECOMMENDATION

The central recommendation of the study is that:

* **the Canadian tax rules should be changed to permit the "mind and management" of international shipping ventures to be located anywhere in Canada on a tax exempt basis**.

The initiative should include shipowning, ship management, and the commercial operation of chartered ships under leases, bareboat charters and timecharters.

6. SUPPLEMENTARY ACTION

An appropriate change in the taxation regime would be sufficient to commence an expansion of activity, but, in order to "jump start" and take full advantage of the opportunity, there is an identifiable, short-term need for a focus for information, education and marketing. The supplementary action recommended by the study is the creation of:

* A Shipping Centre Development Office to be located in Vancouver, for an initial 18/24 month period following the appropriate tax change.

The first year budget for this Office would be in the region of $ 275,000.

7. NATIONAL APPLICATION

This initiative originates with an agency which has a specific mandate to identify and promote opportunities for western Canada in an Asia/Pacific context. The resulting proposal is, however, **totally national in scope and application**.

* **International shipowning and management is a sectoral activity which is relatively easy to define. Therefore, containment of the tax exemption within the group of intended beneficiaries is relatively simple. <u>It does not require a regional dimension</u>.**

The tax exemption, recommended here, would apply to international shipping activities irrespective of the region in Canada where they are managed and controlled. During the course of the study, opportunities were identified for central, eastern and western Canada. They include the retention of existing international shipping activities and enhanced exporter involvement (all regions), the attraction of foreign companies primarily enagaged in Atlantic trading (eastern Canada), and the relocation of foreign companies primarily engaged in Pacific trading (western Canada).

Defining the activity purely by sector, rather than by region, adopts the approach used by the Task Force on Deep-Sea Shipping which reported to the Minister of Transport in 1985. The Task Force, under the chairmanship of Professor Gunnar K Sletmo, recommended a tax exempt status for International Shipping Corporations (ISCs) - in order to stimulate and expand export-enhancing maritime expertise in the Canadian private sector.

8. TAXATION - INTERNATIONAL EQUITY AND EFFECTIVENESS

The thrust of Canadian tax reform, which parallels reforms adopted in the United States and Europe, is to reduce the scope and variety of tax incentives whilst simplifying and cutting tax rates. The intention is to eliminate the disparate tax treatment of various industries in the interests of equity, effectiveness, and the elimination of abuse and the misallocation of resources.

To suggest international shipping activity be accorded "special" tax treatment appears contradictory to the general thrust of these reforms. In this most international of industries, however, equity and effectiveness can only be measured in an international context - and in this context, **Canadian taxation is neither effective, nor equitable.**

In the context of the international shipping industry <u>Canadian taxation is ineffective</u>. Firstly, because it has virtually eliminated this sector from the Canadian economy, despite its obvious importance to trade. Secondly, because no meaningful tax revenues are being generated.

In the context of the international shipping industry <u>Canadian taxation is not equitable</u>. The only equity which matters in this totally international business is international equity - and that demands a tax exempt or tax-free environment.

The industry does not need tax incentives or tax subsidies in order to flourish. What is required is tax neutrality - i.e. a genuinely tax exempt or tax-free environment.

More succinctly:

* **Subjecting unsubsidized international shipping activity to domestic taxation renders it globally uncompetitive and therefore unsustainable. In order to remain competitive, it will remove its mobile assets to more benign jurisdictions, and the activity will diminish or cease to exist in the country which applied the taxes.**

In the simplest terms, this is why Canada does not have an international shipping industry.

Unlike shipping operations in the domestic coasting trades, international shipping is not protected from international competition. The carriage of Canadian exports and imports is part of the competitive global ocean transportation scenario - one where ships necessarily move between different international trades in order to optimise utilisation and earnings, and where freight rates are determined solely by supply and demand. Over the long term, freight rates reflect the absence of tax on vessel earnings.

9. THE TAX REVENUE GAIN

The amount of international shipping activity which is currently based in Canada and which would qualify for tax exemption under this proposal is very small indeed. Much of the limited volume of activity which does take place had been making losses prior to the recent upturn in the freight markets. Several will shortly reach financial positions which entail a tax exposure: and, as a result, they are actively considering a relocation offshore to avoid taxation costs.

Taking into account the relative ease of defining international shipping activities, of controlling transfer payments, and of containing/eliminating the leakage of benefits -

* **The direct cost in tax revenues of the proposed initiative will be extremely small.**

* **The increased level of economic activity in the marine, marine services and general sectors will generate additional tax revenue.**

* **Overall, there will be a net gain in tax revenues.**

10. THE INTERNATIONAL SHIPPING ENVIRONMENT

10.1 A UNIQUE INDUSTRY

International shipping is a unique industry. Its special characteristics may be summarized as follows, it is

* a service industry

* requiring very large capital commitments, e.g.

  US$ 32 million for a new Panamax bulk carrier
  US$ 60 million for a new building large tanker
  US$ 200 million for a new building cruise ship

* whose assets are mobile

* which has been forced to shop internationally for each factor input at least cost, and

* operates in a market place which is

  uninhibited
  internationally competitive, and
  extremely volatile

There is no genuinely suitable analogy or parallel which can be drawn in other industries. International air transport is subject to extensive national, bi-lateral and multi-lateral regulation, and the widespread government ownership positions in national carriers. The international banking and re-insurance sectors contain similar competitive and mobility aspects, but the capital and risk factors are very different.

10.2 RESTRUCTURING

Over the last ten years, there have been substantial worldwide changes in the structure and ownership of the international shipping industry. The changes have been hastened by the length and severity of the shipping recession.

Some traditional maritime countries, such as Norway and the U.K., have seen the size of their national fleets cut by over 75% during the period. Concurrently, there has been a substantial increase in the number of ships and the amount of tonnage (cargo capacity) entered under "open" registers - such as Panama, Cyprus, the Bahamas and Vanuatu. Open registers now contain some 40% of the total world fleet of deep-sea ships. The main beneficial users (ultimate owners) of these registers are the U.S.A., Greece, Japan, Hong Kong, Norway and the U.K.

In general, deep-sea ships operating under the national flags of high-cost developed countries have become uncompetitive and unprofitable. Various measures have been attempted in individual OECD countries to arrest the decline, but the results suggest that they have been expensive failures. The only successful national initiative has been the parallel or second register pioneered by the Norwegian International Shipregister (NIS).

The NIS has been a major factor in repatriating Norwegian-owned foreign-flag ships, and preventing the further transfer of Norwegian-owned ships to foreign flags. It has been unsuccessful, however, in attracting any significant number of foreign-owned ships. The NIS permits the use of non-national crew. The other major component in the recent expansion of Norwegian shipping activity is the extensive use of K/S tax shelter partnership schemes. These K/S partnerships, which defer personal taxation at Norway's very high marginal tax rates, have provided most of the risk capital which has funded this growth - some $3 billion over the last two years.

10.3 INTERNATIONAL TAX POLICIES

Tax Subsidy Programmes have frequently been the source of equity and debt funding for the shipping industry in the traditional maritime nations. Most of the programmes have been costly and of limited duration.

The performance of the international shipping industry over the last fifteen years shows quite conclusively that long term stability can be maintained when the shipowner operates in a wholly **Tax Neutral Environment**. It is evidenced by such things as the growing success of the open registers; the performance of the U.S. controlled foreign-flag fleet prior to and during tax reform; and the on-going growth of the Hong Kong shipping community.

10.4 FACTOR INPUTS

The Open Registers and the NIS are successful because they allow a shipowner to combine the various items which make up his costs by sourcing each one in the global market place. This applies to the cost of all factor inputs: whether it is officer and crew wages and benefits, new and second-hand ships, ship financing, subsidies, investment funds, repairs and drydocking, insurance, tax, administration, or flag.

Access to some of these factors are often restricted by the administration of the country in which the shipowner is based. There are two specific and crucial components which are likely to be subject to national restrictions:

* **crew nationality, and**

* **access to, and accumulation of, tax-free funds for investment and reinvestment in ships.**

The following conclusion is difficult to escape:

* **If the use of either HIGH COST LABOUR or HIGH COST MONEY is mandatory, shipowners cannot be internationally competitive.**

11. CANDIDATES/TARGET GROUPS FOR RELOCATION/EXPANSION

11.1 FOREIGN INTERESTS

Neutralisation of the negative taxation issue is sufficient to attract foreign shipowners and managers where these target groups are already interested in British Columbia, particularly if they are subject to existing or potential disadvantages where they are currently located.

The following groups are the main targets:

* **FOREIGN SHIPOWNERS** with existing and potential freight interests in western Canada - primarily **SCANDINAVIAN, EUROPEAN and JAPANESE**. High domestic establishment costs in their current locations provide an additional incentive.

* **HONG KONG SHIPOWNERS** looking for alternatives as 1997 approaches.

* Companies presently classified as **U.S. BENEFICIAL OWNERS**, who are contemplating severing the U.S. linkage in order to retain full control over their foreign-flag shipping operations (one result of tax reform in the U.S.A.).

The initiative has generated considerable enthusiasm in several shipowning companies and individuals who are either engaged predominantly in the Pacific trades, or have a significant Pacific Northwest cargo base/interest. The most positive response has come from the BULK SHIPPING SECTOR - dry and liquid bulk shipowner/operators.

11.2 CANADIAN INTERESTS

Elimination of the negative taxation issue will encourage Canadian exporters and importers to expand their involvement in the ocean transportation of their products. **CANADIAN EXPORTERS** are major supporters of the initiative. The strategic control of ocean transportation is especially relevant to Canadian exports, where ocean freight costs are a substantial element in the landed cost of the low value natural resource commodities which dominate the offshore export mix. Exporters recognise that the initiative will enhance their competitive options - to sell on a CIF basis (cost, insurance and freight); to engage in ship chartering activities; and to take ownership positions in suitable ships.

Several of the limited number of **CANADIAN-BASED SHIPOWNERS** and **OPERATORS/CHARTERERS** with interests in foreign-flag ships are presently contemplating moving the "mind and management" of their international operations out of Canada. In some instances, the decision to expatriate has already been made. This includes companies in eastern and central Canada as well as British Columbia. These moves will continue the

tax-induced expatriation of Canadian international shipping operations, which has resulted over the years in a significant loss of expertise and economic benefit by Canada to the United States, Bermuda, and Europe. **Prompt adoption of the central recommendation of the study would ensure that these operations remain in Canada.**

The two largest Canadian owned companies, which established shipowning and operating subsidiaries offshore during the 1960s and 1970s, have indicated that they are unlikely to repatriate these operations to Canada - even if a fully tax exempt environment were to develop. Over the years, their offshore subsidiaries have reached a position where the majority of employees are no longer Canadian, and where they have substantial joint venture and other foreign commitments. Present venues already provide the tax advantages which are under discussion here. Consequently, repatriation holds only limited attractions.

The rather negative response from existing expatriate Canadian companies suggests that those Canadian companies currently faced with a tax-driven move offshore are unlikely to repatriate once they are established offshore.

Several of the smaller ship operators and owners contacted, who either maintain their "mind and management" offshore, or have severely restricted the extent of their current operations, have indicated that they would either repatriate, or expand, these functions in Canada - if the taxation treatment became internationally competitive.

12. THE WINDOW OF OPPORTUNITY

An appropriate change in the tax treatment of international shipping, will give Vancouver a unique business environment on the American coast of the Pacific Basin, and one which will be competitive with Asian centres - specifically Singapore and Hong Kong.

In order to take advantage of the opportunity, the tax changes recommended in the report must take place promptly.

A variety of upheavals in international shipping have created an extraordinarily fluid situation which will not last long.

* The major recession in the shipping markets is over, but present earnings are inadequate to justify the new building programmes which will be required if shipowners are to remain in business over the long term. Although cost pressures have eased, shipowners are well aware that they must explore every opportunity available on a worldwide basis in order to remain cost competitive.

* The national links between the shipowner, the country of corporate domicile, and the country of ship registration have been overturned.

* The political situation in Hong Kong is focussing corporate and individual thinking in Asia on the range of factors involved in a major relocation, and on the alternative venues available. Current immigration to Vancouver provides the city with a unique opportunity in this context.

* Tax reform in Europe and America is quickly eroding the benevolent business environments which have been available to shipowners through exemptions and subsidies. These changes are driving shipping activity away from some traditional centres to other locations which are internationally competitive.

Concurrent with the international adjustments summarised above, Canada (and British Columbia, in particular) has become much more aware of the importance of trade, logistics and the international business environment to its economy and long term development.

* There is a heightened recognition in Canada of the importance of logistics in meeting global competition. This is increasingly apparent in western Canada. Trade with the Pacific Basin continues to grow in relative importance, and ocean transportation is the predominant factor in the logistical chain.

* Western Canada has become very aware that, in order to develop, it must shift its economy away from the extraction of primary resources into the supply of services to international markets. Shipowning, operating and management is a major international service industry which fits perfectly within the desired development pattern.

13. THE DESIRABLE BUSINESS ENVIRONMENT

The study has determined that a suitable business environment for international shipowning and management would contain the following essential or desirable features.

13.1 GENERAL PRINCIPALS

Laissez faire policies.
A minimum amount of rules, which are not subject to frequent change.
Political stability.

13.2 SHIP REGISTRATION AND CREWING

No restrictions on the flag/registry of owned/operated ships.
No restrictions on manning nationalities.
Acceptance of the respective jurisdictions of the authorities providing ship registration and supervising the crewing agreement.

13.3 COMMUNICATIONS

Competitively priced, reliable and accurate international communications: telephone, fax and telex.

13.4 QUALITY OF LIFE

Pleasant living conditions.
Cultural and ethnic tolerance.
Affordable good quality housing.
Internationally competitive living costs.
A non-corrupt, non-violent environment, with an established work ethic.

13.5 GEOGRAPHY

A centralised location in relation to trading patterns: cargo, cargo interests, ports of call, ship repair and shipbuilding yards.

13.6 MARKETS

Easy access to the market place, i.e. proximity to established shippers, charterers and information.
Proximity to a regional freight (and passenger) market.
The existence of a "maritime community".

13.7 ACCESS TO SERVICES

A world class business centre.
Financial:
- Good access to shipping finance, banks, institutions and financial markets.
- Competent and rapid banking transactions, especially international money transfer.
- Unrestricted foreign exchange transactions.

13.8 MEDIUM AND LONG TERM GROWTH PROSPECTS

A bouyant development outlook.

13.9 LABOUR

Access to an expert labour pool - to fill positions requiring specialist qualifications/experience.

Access to a competent labour pool - for general positions.
Good working attitudes.
A non-militant labour force.

13.10 ESTABLISHMENT COSTS

Internationally competitive office/establishment costs: labour, office space and services.

13.11 IMMIGRATION & WORK PERMITS

Immigration status for:
- the foreign shipowner and dependents,
- key personel and dependents.

Work permits for seconded marine staff.

13.12 THE TAXATION REGIME

A tax-free or tax-exempt corporate environment.
A flexible personal tax regime for the entrepreneur shipowner.

14. TRADE SUPPORT - MARITIME EXPERTISE

With 46% of its GDP trade dependent, the Canadian economy is more reliant upon international trade than many of its main trading partners and competitors. By comparison, the proportion of the U.S. economy which is trade dependent is 14%, for Japan it is 17%, Australia 28%, and the United Kingdom 43%.

The 1985 report of the Task Force on Deep-Sea Shipping took full cognizance of the importance of trade to the Canadian economy:

* Shippers need to "have unimpeded....access to an efficient and competitive transportation system of which international shipping is an integral part", and

* the "presence of a strong basis of shipping expertise within Canada is essential in order that Canada may respond more effectively and forcefully to the complex and changing international shipping environment and protect its exports and imports".

The Task Force went on to recommend that Canada adopt policies to encourage and strengthen its expertise and interests in international shipping. The policy vehicle recommended to achieve the objective was the International Shipping Corporation (ISC). That recommendation was directly aimed at stimulating the onshore ownership and control of international shipping. In turn, the shipowning and control functions would generate additional demand for, and foster the development of, the maritime service sector.

Summarising:

* **In order to compete effectively, Canadian importers and exporters must have access to maritime expertise.**

* **To maintain and develop the essential maritime expertise domestically, Canada needs a competitive international shipping industry.**

15. PREVAILING POLICY

Canadian involvement in international deep-sea shipping under the national flag has proved uncompetitive under peace time conditions - and virtually disappeared shortly after the Second World War. It has not revived. The situation has resulted in a number of proposals for supportive government action over the intervening years, and they have usually incorporated a tax preference factor.

As a matter of policy, government has protected Canadian ships which trade between Canadian ports from foreign competition. Successive governments have been unprepared, however, to support Canadian ships in international trade through subsidy or cargo reservation. The policy of non-intervention has been examined and re-affirmed on several occasions since the War, most recently by the Task Force on Deep-Sea Shipping which reported in 1985.

With internationally uncompetitive costs under the domestic flag, some participation of Canadian companies in international shipping has developed through the ownership and control of ships registered offshore and flying foreign flags.

Canadian shipowners are not unique in adopting this route. Many other countries, with uncompetitive costs under their national flags, effectively own and control extensive fleets under foreign flags, e.g. United States, Japan, and countries in Europe and Scandinavia. Reliance on offshore flags has accelerated worldwide in the last five years as the extraordinarily low freight markets produced tremendous pressure on operating costs. Historically, most of the governments involved have been sympathetic, if not explicitly supportive, of the switch from direct ownership under national flag to beneficial ownership under foreign flag.

16. SOME PREVIOUS PROPOSALS

16.1 CANADIAN PACIFIC

In the early 1960s, Canadian Pacific was contemplating an expansion of its shipping activities beyond its traditional liner operations into the international bulk trades. An approach was made to the Canadian government requesting that the new venture's management and control be permitted to operate onshore in Canada - but with the taxation regime adjusted to internationally competitive levels. An accommodation proved impossible, and Canadian Pacific

established its extensive foreign-flag bulk operations in Bermuda and the United Kingdom.

16.2 THE TASK FORCE ON DEEP-SEA SHIPPING

The central task set for the 1984/1985 Task Force on Deep-Sea Shipping was to examine whether government should take action to encourage the expansion of the Canadian deep-sea fleet in the light of changing circumstances. Having recommended that no such action be taken, the Task Force went on to recommend a tax exemption for Canadian-based international shipowning and management activities **irrespective of flag**.

16.3 THE CANADIAN SECOND REGISTER

Since 1985, several Canadian shipowners principally enagaged in the Great Lakes and St Lawrence have expanded into the international deep-sea trades. This has involved re-assignment of existing ships and the introduction of new vessels. Over half of these ships (perhaps eight units out of some twelve involved) are now registered under foreign-flags and employ foreign officers and crew.

A Canadian Second Register has been proposed recently, in an attempt to address the competitive disadvantage of Canadian registered and Canadian crewed ships in international trade. The prime objective is to prevent further transfers of ships to foreign flag, and to recapture the limited number of ships already lost. The "second" or "parallel" register was pioneered by Norway in 1987. It is a method of achieving international cost competitiveness, whilst maintaining a national affiliation.

The Canadian proposal includes cost savings for the shipowner through tax exemptions: a corporate exemption on international business; and an exemption for crew wages, which continue to be paid at the same pre-exemption net level. It is similar to some arrangements which have been permitted under British, German and Danish flags; but **the proposed measures do not permit the flexible manning conditions which now prevail internationally under many national flags and under those second registers which have been successful.**

Consequently:

* **the cost of operating a ship registered under the proposed Canadian Second Register would remain internationally uncompetitive** - albeit by a reduced margin.

Transport Canada issued a paper in September 1988 which compares the Second Register proposal with the International Shipping Corporation (ISC) model developed by the Task Force. The ISC model has a much broader appeal. The business environment proposed by the Task Force and supported by this study is internationally competitive, and therefore has the potential for success. In addition, its application is universal and not restricted to a very limited number of existing Canadian firms.

Whilst the Second Register may be considered a worthwhile supplement to the ISC proposal, it is one that should be judged on its own separate merits. Its limited objectives should not detract from the broader sweep of the study.

17. THE CANADIAN COASTING TRADES

Foreign ships and non-duty paid Canadian ships are not generally permitted to trade between Canadian ports without prior application and receipt of a coasting license. A license is only issued after the payment of any import duties and taxes which may be applicable. Foreign-flag ships owned and controlled in Canada are also subject to these restrictions.

As the objective of the proposal is the enhancement of Canadian involvement in international shipping, the **proposed tax exemption should not be granted in respect of any earnings generated by voyages in the Canadian coasting trades and the Great Lakes.**

18. CANADIAN SHIPS AND SEAFARERS

The recommendation of the study does not contain a "flag dimension". Shipowners and operators based in Canada would be allowed an internationally competitive taxation regime for their international shipping operations irrespective of the flag or registration of the vessels involved.

The arrangement does not preclude the employment of Canadian-flag ships or Canadian seafarers. The use of Canadian ships and seafarers would be at the option of the shipowner or charterer, and subject to free market decisions based upon competitive cost levels and rates of hire.

The quality and amount of maritime management expertise in Canada will grow as a result of the initiative. **The expansion of Canadian-based commercial and technical competency will ensure that additional opportunities for Canadian ships and seafarers will be identified and exploited.**

19. VANCOUVER'S FAVOURABLE CHARACTERISTICS

Vancouver's business environment compares exceptionally well with the "ideal" location. The city has some very major factors working in its favour, and they include:

* **political stability**
* **good, competitively priced communications**
* **an exceptional quality of life**
* **cultural tolerance**
* **an excellent North American location for Pacific Basin operations**
* **a workable time zone**
* **a substantial regional cargo base**
* **unrestricted foreign exchange transactions**
* **access to a base of established maritime services**
* **a competent general labour pool**
* **competitive establishment costs**
* **excellent development prospects**

With the exception of the taxation issue, Vancouver meets all of the "essential" requirements. In addition, it compares favourably, or is at least competitive, in most other areas.

No location would meet the ideal, and there are naturally a few areas in which Vancouver suffers from minor actual, or perceived, constraints. They are individually addressed below.

20.1 POTENTIAL SHORTAGES OF MARITIME SKILLS

Two areas of concern are products of the present level of development of Vancouver as a regional maritime centre. They are:

* the availability of maritime services
* the supply of specialist labour.

The **MARITIME SERVICES SECTOR** in Vancouver has developed to service local and regional demands. It represents an established core of expertise which has the capability to respond and grow fairly rapidly to meet the additional demand which an international shipowning/management community would make upon it. There are some areas which currently do not exist (ship financing), others which are less developed (marine insurance), and some which are quite well established (shipbroking).

As part of the objective of the initiative is the development of the maritime services sector, the existence of a workable base should be viewed as a very positive attribute. The current limitations need only be temporary, and supply will respond to the increased demand over the medium term.

The availability of **WORKERS WITH SPECIALIST SHIPPING SKILLS** can be an important factor in the choice of a location for shipowning and management actvities. It was a factor in the recent decisions concerning head office locations which have been made by several new cruise lines setting up in the United States. In the cargo sector, Vancouver is regarded as having a reasonable supply of regionally-oriented commercial and operating/cargo personnel. Some skills are potentially in short supply - such as low-speed marine diesel supervisory capability, and some areas of ship management.

The labour market in Vancouver for specialist maritime skills has been fairly balanced over the last few years. There has been a small surplus of operations personnel and a slightly tighter position for marketing staff. In addition, there is a fairly significant number of competent marine staff working in other industries, including a number of recent immigrants.

As in the maritime services sector, there is a basis of specialist maritime labour available in Vancouver on which to build. Foreign shipowners and managers will need to transfer key personnel to Canada as part of the relocation process. Short term deficiencies can be rectified through the issue of work permits and limited immigration for qualifying individuals. The process will be similar to the expansion of marine activity which took place in British Columbia during the 1950s and 1960s. At that time, immediate shortfalls in maritime expertise were covered by offshore recruitment

(mainly from Britain and Scandinavia). Concurrently, Canadian entrants into the maritime industry received hands-on training, and developed specialist skills over the medium term.

Implementation of the recommendations of the initiative will create a significant demand from the private sector shipowner for specialist maritime personnel and service firms in the medium term. The response of the private sector to the opportunities arising from the sustained demand will expand the supply function. The support of educational and training institutions will be necessary, however, and there are appropriate, interested institutions in Vancouver.

20.2 INTERNATIONAL AIR ACCESS

Vancouver's international air access was considered to be generally adequate by most contacts. Several U.S.-based cruise lines, however, with extensive Canadian experience consider that Vancouver has major drawbacks when compared to U.S. locations. The negative features include limited trans-border flights, and the more difficult access to some locations when compared to the main U.S. hubs.

20.3 BANKING AND THE INTERNATIONAL TRANSFER OF FUNDS

International ship operating is very dependent upon the quick and accurate international movement of large sums of money. The failure of the banking system to transfer funds at short notice can easily result in the costly detention of a ship in a foreign port. Similarly, there have been many instances internationally of ships being withdrawn from charter, especially in a rising market, because hire monies were not received in the designated bank on time.

There was a litany of complaints from organisations with experience in western Canada concerning delays in the international transfer of funds. Complicated routings (via Toronto/New York), limited tracing capability, and a lack of appreciation of the need for speed and accuracy were the main issues raised. The Canadian banking community must become responsive in this area if Vancouver is to achieve international competitiveness.

20.4 LABOUR CLIMATE

The international shipping industry's perception of the labour climate in British Columbia is generally poor. The perception arises partially from press coverage, but also from actual experience of the British Columbia waterfront.

Two specific labour concerns were expressed with respect to locating shipowning/managing activities in Vancouver:

* potential unionisation and militancy of office workers

* possible action by the International Transport Workers' Federation (ITF) against foreign-flag, foreign-crewed ships calling at Vancouver which are owned or controlled by Canadian-based operators.

20.5 THE AGGREGATE TAXATION ENVIRONMENT

Vancouver's favourable attributes as a potential centre for international maritime commerce far out-weigh the negative items detailed above.

The fundamental constraint, which has ensured that Vancouver has not achieved its natural potential as a major international centre for maritime commerce, is the internationally uncompetitive tax treatment of shipping companies which establish their "mind and management" in Canada.

The application and the level of Canadian personal taxation may also deter some foreign shipping entrepreneurs. Personal tax exemptions for Canadian residents are not part of the proposal. The combination of the corporate tax exemption for international shipping with the tax-free payment of dividends to foreign shareholders would encourage the relocation of shipowning and management activity to Canada - even if the shareholders do not personally relocate.

Shipowners who are used to very simple taxation systems (such as Hong Kong) have difficulty with the complexity of the Canadian taxation system. Others have voiced major concerns over the related concept of "negotiating" a settlement with the authorities, and the uncertainty it entails. It is anticipated that these concerns are likely to prove superficial. A serious interest in taking advantage of a genuine Canadian proposal will quickly result in the retention of appropriate advisers, and the reduction or elimination of this unease.

21. OTHER CENTRES

LONDON and **NEW YORK** have been the predominant centres of international maritime commerce for many years. Each is a major continental trading centre, and a market in international freight developed in both locations to service the trade function. London had the benefit of extensive shipowning under national flag, and both the U.K. and the U.S.A. provided business environments conducive to the development of a cosmopolitan shipowning community. **TOKYO**'s maritime activities tended towards a narrower national development pattern, and international shipowners have usually limited their Japanese presence to local marketing representation.

21.1 THE COMPETITION

Over the last thirty years **HONG KONG** has developed into a major centre for shipowning activity. Originally, the commercial emphasis was on long term employment and Hong Kong's growth as an international chartering/freight market has been relatively slow. **SINGAPORE** is the other main Asian centre for international maritime activity, and the business environment has been specifically structured to encourage its growth.

Development of the international maritime sector is a significant feature of various programmes adopted by cities and countries intent on achieving international business status. Usually these programmes have been associated with the creation and promotion of a ships register; examples include Bermuda, the Bahamas, Cyprus, Luxembourg and Singapore. Other shipping centres have developed, or have been maintained, because of tax treatment policies specific to shipping, or general taxation policies which have accommodated shipping activities. Hong Kong, London, New York, Switzerland, Monaco and others can be included in this category.

Shipowners based in Hong Kong are examining the alternatives available to them in the context of 1997. The Hong Kong shipowner community includes both Chinese and non-Chinese operations (European, Japanese, and others). A broadly spread relocation to Asian, European and other locations which offer tax advantages is possible. It is more likely, however, that much of the movement anticipated will be to one or two main venues. At present, Singapore is favoured.

Singapore has constructed a special taxation regime to attract foreign companies to locate regional headquarters on the island. The preference involves concessionary tax rates which reduce the normal corporate rate from 33% to 10%.

The Singapore authorities recognise the economic value of foreign and domestic maritime activities, and international shipping receives preferential taxation treatment and is generally tax exempt. It has been successful in attracting Norwegian and West German shipowning interests to place vessels under Singapore flag, and to base some shipowning and managing activities in the country. An on-going dialogue is taking place between the authorities and certain Hong Kong shipowning interests, and this is aimed at creating a modified taxation framework which would meet their respective interests.

21.2 THE ROLE MODEL

GREENWICH, Connecticut, is an interesting and recent example of the development of an international maritime centre. The existence of a benign taxation regime at the federal and state levels, proximity to major markets, and a pleasant, inexpensive working/living environment were the initiating factors. Some of its original advantages have disappeared, but Greenwich's maritime community continues to grow as international shipping companies and maritime services relocate. Greenwich has passed a certain threshold level and the development process has achieved its own momentum.

Greenwich has a discernible Atlantic trading bias. There is a broad mix of European, Scandinavian, and Greek shipping interests in addition to east coast North American interests (American and Canadian). Asian participation is small.

Greenwich is undoubtedly a good role model for Vancouver - replacing the Atlantic trade/European emphasis with a Pacific trade/Asian orientation.

In the Pacific Basin most maritime activity is regionally or nationally based. At present, Hong Kong and Singapore are the only significant international maritime centres. Nothing comparable exists anywhere on the American side of the Pacific, and Vancouver is the most logical candidate - providing the taxation issue is properly addressed.

THE ASIA PACIFIC INITIATIVE

On December 16, 1986, federal and provincial ministers signed a Memorandum of Understanding (M.O.U.) calling for the coordination of initiatives to enhance British Columbia and Vancouver as Canada's Pacific Centre for trade, commerce and travel. The M.O.U. was later designated as the Asia Pacific Initiative.

On June 2, 1987, the Asia Pacific Initiative Advisory Committee (APIAC) – drawn from the private sector – was established to advise federal and provincial ministers of initiatives that might be undertaken to achieve the objectives of the M.O.U. This advice is transmitted by the APIAC to the federal-provincial Pacific Council of Ministers through a Ministerial Executive Committee that meets regularly with the APIAC.

The APIAC has appointed task forces that are addressing opportunities and advising the Governments of Canada and British Columbia in the areas of international finance, trade, transportation, tourism, cultural and social impact and the export of professional services. More than 100 volunteers from the private sector are engaged in this work.

ASIA PACIFIC INITIATIVE